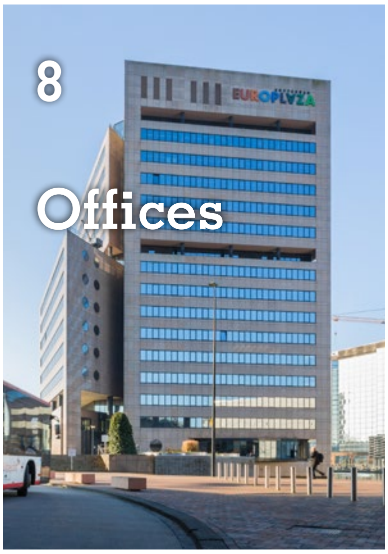
Real estate market update

Second quarter 2022

a.s.r. real estate

Contents



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Economy

With surging consumer prices throughout the first half of 2022 and economic growth that is expected to cool down as a result of stagnating consumer spending and rising interest rates, it is now more than likely that economies worldwide will be entering a phase of high inflation and low economic growth for the first time since the 1970s.

GDP growth	y-o-y real	Q2 2022	5.3%	Q1 2022	6.7%	↘
Consumer prices	y-o-y inflation (HICP)	Q2 2022	10.4%	Q1 2022	8.9%	↗
Consumer confidence	Average balance	June 2022	-50	March 2022	-39	↘
Unemployment	ILO unemployment rate	Q2 2022	3.3%	Q1 2022	3.7%	↘
Private consumption	y-o-y consumer spending	Q2 2022	7.0%	Q1 2022	13.4%	↘
Producer confidence	Average balance	June 2022	8.1	March 2022	8.7	↘

Source: Statistics Netherlands (CBS), Eurostat, 2022 | The arrows refer to the experienced change over the comparison period.

To keep economies worldwide afloat, the monetary policies of central banks during the COVID pandemic led to price increases in the second half of 2021. However, since the start of 2022, the war in Ukraine, back-and-forth trade sanctions with Russia and China's zero-COVID policy have caused a significant supply shock worldwide, worsening the economic situation and outlook.

Consumer prices saw the highest year-on-year increase since 1945 by the end of March 2022 (11.7%), but they have cooled down somewhat since, to 10.4% on average in the second quarter. This is still mainly attributable to increases in energy and fuel prices, but the cause has also become more widespread: prices of consumer goods, especially food, have also increased considerably. As a result, consumer price increases in the Netherlands were well above the eurozone average of 8.1% in June; they were among the top risers in Western Europe.

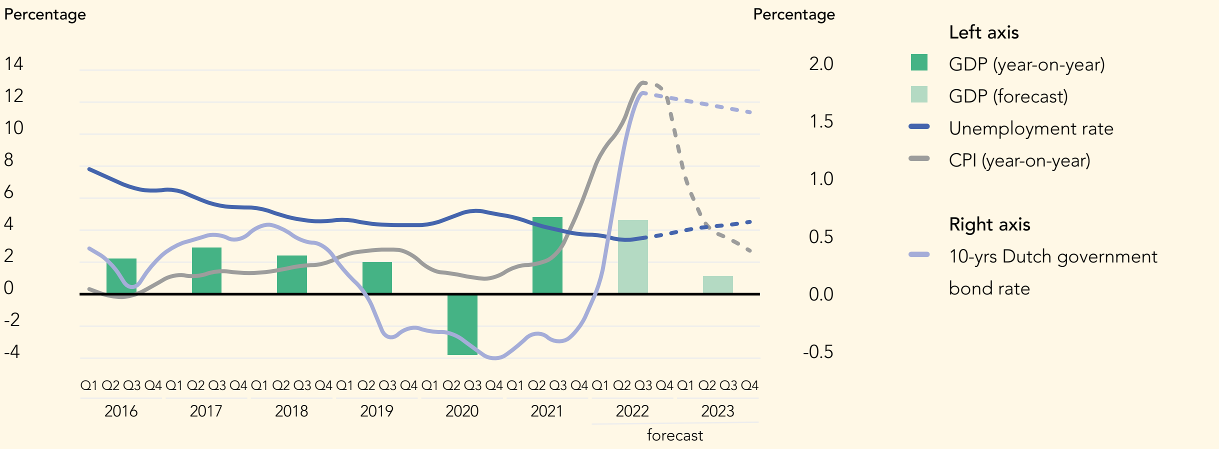
With ongoing price increases and economic uncertainties ahead, consumer confidence reached a record low in June (-50). Although consumers are mostly pessimistic about the economic climate, they are least pessimistic about their own financial situation. This can mostly be attributed to the unemployment rate that hit an all-time low of 3.3% in the second quarter, which is half the average unemployment rate in the eurozone. Although this year's wage increases will not keep up with general consumer price increases, maintaining their income gives many households a relatively positive financial outlook. Producer confidence stayed positive compared to the long-term average, ending the quarter at 8.1.

The ECB remained relatively calm in the first quarter about the persistent rise in consumer prices. However, they announced a key interest rate increase in June for the first time in 11 years and unofficially announced more rate hikes for the remainder of 2022. In doing so, the ECB follows the Fed, which has introduced several interest rate hikes since the start of the year. Also, the ECB is phasing out quantitative easing by discontinuing its net asset purchases under the pandemic emergency purchase programme (PEPP). However, to ensure that bond rates of different Member States do not diverge too much, thereby weakening the entire monetary union, a new financial instrument is being considered that, in practice, would serve as a support system for the southern Member States with higher debt rates.

The interest rate of Dutch government bonds has steadily increased since the start of the year, ending the second quarter at an average rate of 1.15% after having been negative for nearly three years. As a result, mortgage rates have also increased considerably since the start of the year.

In its last economic forecast (August 2022), the Netherlands Bureau for Economic Policy Analysis (CPB), assumes that, despite rising consumer prices and a significant decline in purchasing power of Dutch households, **the Dutch economy keeps growing at a rate of 4.6% in 2022 but will cool down in 2023 (1.1%).** This can be mainly attributed to household's consumption that is expected to cool down in the second half of 2022 and will contract in 2023 by 0.3%.

Figure 1 Dutch economic indicators



Source: a.s.r. real estate, Statistics Netherlands (CBS), Eurostat, CPB, Consensus Forecast, ECB, 2022

Retail

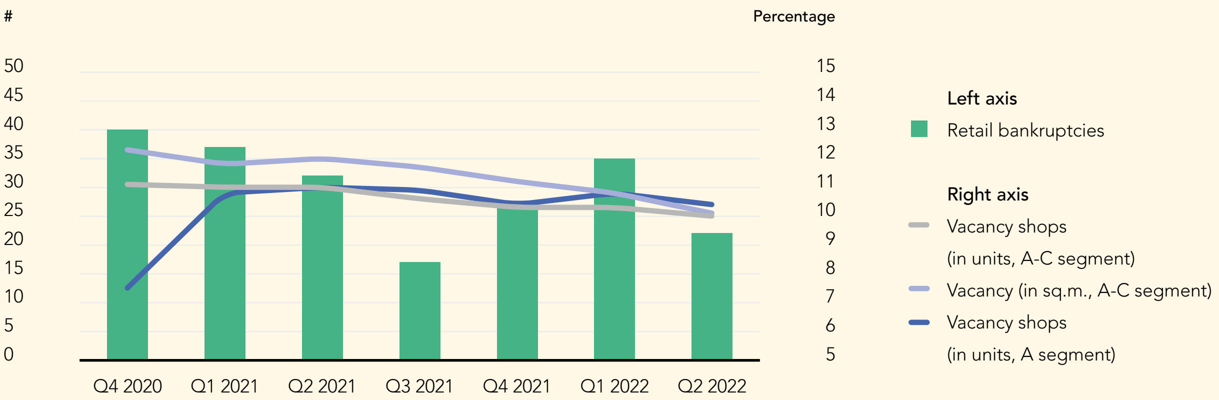
Redevelopment completions and strong non-food turnover growth has resulted in positive momentum in Dutch high streets. Furthermore, increased investment volumes demonstrate growing investor interest in retail assets.

Continuing recovery of retail consumption as restrictions are eased. Non-food retail turnover continued its recovery reaching a y-on-y increase of 44.1%, whereas the decrease in food retail turnover stabilised somewhat at around 0.7% as Q1 2022 saw even more covid restrictions being eased. As a result, online shopping growth dropped by a record rate of 19.7% in Q1, marking the first negative y-on-y growth since measuring started in 2014.

Vacancy rates are starting to show a minor decline. Vacancy rates in the A and A-C segments seem to have left their peak behind and have started showing a slight decrease towards 10% . One of the important drivers for the decline is redevelopment into non-retail like housing or office spaces. Early signals of increased demand at prime locations (A1/A2) also helps to temper vacancy rates. Equally, the decline in the number of physical retail stores seems to have come to a halt. Nevertheless, high street market rental values are still under pressure.

Capital has found its way back to Dutch retail. Retail yield gaps have reverted towards their long-term average as a result of increasing interest rates. Nonetheless, the yield gaps are still historically favourable. Moreover, investment volumes in the first half of 2022 were considerably higher than in the same period the year before and slightly higher than the long-term H1 average of 2008-2021. A large institutional investor showed retail appetite by purchasing high street assets in Eindhoven and Rotterdam. Consequently, investments in the high street segment kept their momentum as yields remained attractive and consumers spent generously in city centres.

Figure 2 Vacancy rates and bankruptcies



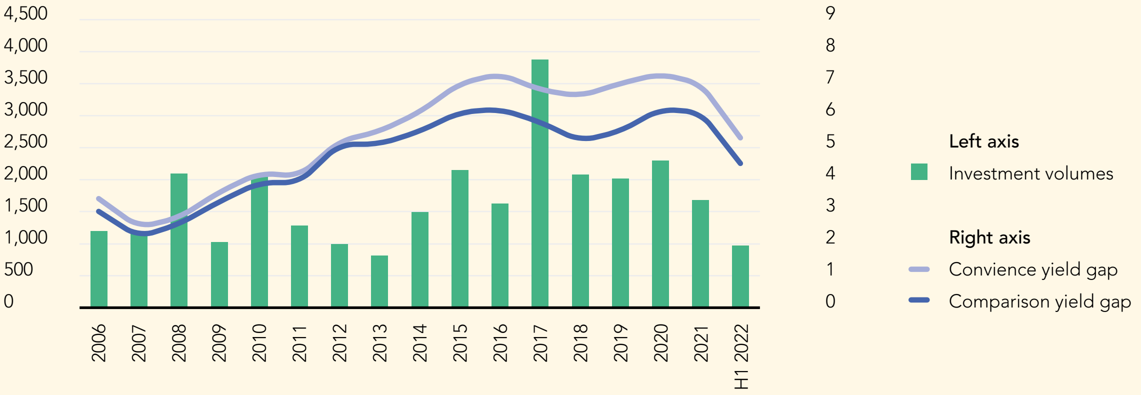
Source: Locatus, Statistics Netherlands, 2022

Outlook

Persistent inflation and slower recovery. High inflation seems to be more persistent partly due to the ongoing Russian-Ukrainian conflict. Consequently, central banks are trying to tackle fast rising prices with historical interest rate hikes. Therefore, the outlook for the coming quarters continues to be uncertain, which is reflected in low consumer confidence. Despite economic uncertainty and high inflation, private consumption growth is expected to remain positive in 2022 and 2023.

Investors reconsider retail exposure. Decreasing yield gaps, higher transfer tax, increased debt costs and uncertainty about increasing retail rents to compensate for inflation force investors to rethink their retail exposure. We expect investors to stay very selective of high street acquisitions. Convenience retail and especially supermarkets could still be considered a safe haven as consumers will continue to buy primary goods, although peaking energy and grocery prices force consumers to spend wisely.

Figure 3 Retail segment yield gaps[1] and retail investment volumes



Source: MSCI, CBRE, ECB, 2022

1 Yield gap calculated on reversionary yields and 10-yrs Dutch government bond rate, as of Q1 2022.

Residential

The mismatch between supply and demand keeps increasing on the Dutch housing market, but rising interest rates and prospective (rent) regulations are expected to stand at the basis of a cooling down of the (rental) housing market.

Owner-occupied market

In the Dutch owner-occupied market, transaction prices increased once again in the first quarter, by 4.2% quarter-on-quarter, resulting in a year-on-year increase by 20.3%, the highest year-on-year increase ever recorded on a quarterly basis These continuous increases are due to a combination of increased market tightness, as a record-low number of houses are up for sale while demand remains high. However, during the second quarter, price increases stagnated somewhat (18.4% year-on-year), which might be the result of the increase in interest rates in the first half of 2022, making homebuyers slightly more cautious.

Although the number of transactions during the first quarter was the lowest in six years (44,000), **the second quarter recorded approximately 47,000 house transactions,** which is in line with previous years where the first quarter has always been the least dynamic. Still 47,000 marks a 10.2% drop compared to the second quarter of 2021. Again, the historically low supply of houses that are for sale keeps causing this low number of transactions.

Residential investment market

The total return of the Dutch residential property market in the second quarter of 2022 was 20.8% year-on-year. This corresponds to a 5.5 percentage-point increase against the previous quarter, which is notably higher. Accounting for a significant share of this increase, capital growth was up from 12.1% in the first quarter of 2022 to 17.5% this quarter. This means that the increased pressure on the residential investment market persisted and continues to move in line with the owner-occupied market. As a result, income return decreased slightly to 2.8% year-on-year, coming from 2.9% in the previous quarter.

The total return of single-family houses outperformed that of multi-family apartments for the fifth quarter in a row, mainly due to capital growth of single-family houses, which showed an accelerating increase compared to multi-family apartments.

In the first quarter of 2022, market rental value growth remained relatively stable at 4.3% year-on-year. Now that consumer prices have increased significantly since the fourth quarter of 2021, both market rental value growth and actual rent passing growth have been unable to outperform CPI for the first time since 2013.

While yields seemed to bottom out in the first year of the pandemic, compression has continued since last year. By the end of the first quarter of 2022, yields stood at 4.0%, an 11-basis-point decrease compared to the previous quarter.

Outlook

With rising consumer prices, subsequent interest rate hikes and an economic growth that is expected to cool down, **the Dutch residential market is likely to experience some headwinds in the current as well as next year.** That said, price increases are expected to continue as the general fundamentals of the housing market remain favourable: delays in adding newly-built homes to an already tight supply and demographic developments that keep putting extra pressure on the pre-existing housing shortage.

Market uncertainties in the owner-occupied market have increased, however. Rising mortgage rates will likely affect the financial capabilities of many, especially mid-income households. Also, now that negative consumer confidence has proved to be persistent, demand for owner-occupied housing may decline faster than expected, which would mean fewer transactions and a cooling-down of house prices.

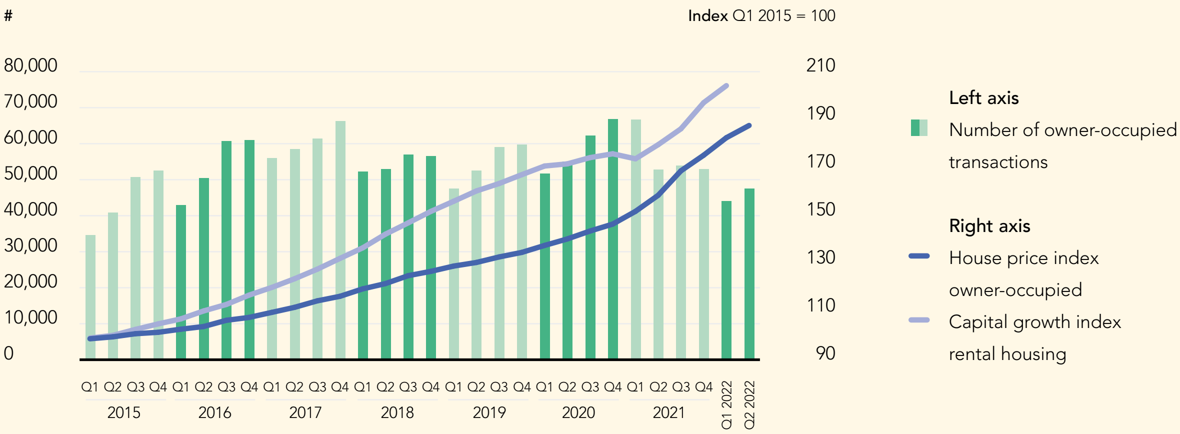
These uncertainties will not yet have an impact on house prices this year, but their impact will be felt in 2023. For this year, increases in house price are still expected to be considerable as the residential market remains extremely tight. Indeed, the housing supply will not increase significantly as rising building costs, labour shortages and environmental regulations make the feasibility of many property developments uncertain. As a result, this year, prices are expected to rise by approximately 12.5% to 15.0% followed by an expected 3% in 2023.

With increasing interest rates, it is likely that yields for the residential investment market will bottom out this year and increase slightly in the years ahead.

Still, strong owner-occupier market fundamentals and the partial inflation hedge of rental housing might counteract the decreasing spread between residential real estate yields and the risk-free rate of Dutch government bonds. Furthermore, the supply of liberalized rental homes is stalling due to increasing government interventions in the market, which keeps the pressure on rents although the government is keen on keeping rents affordable.

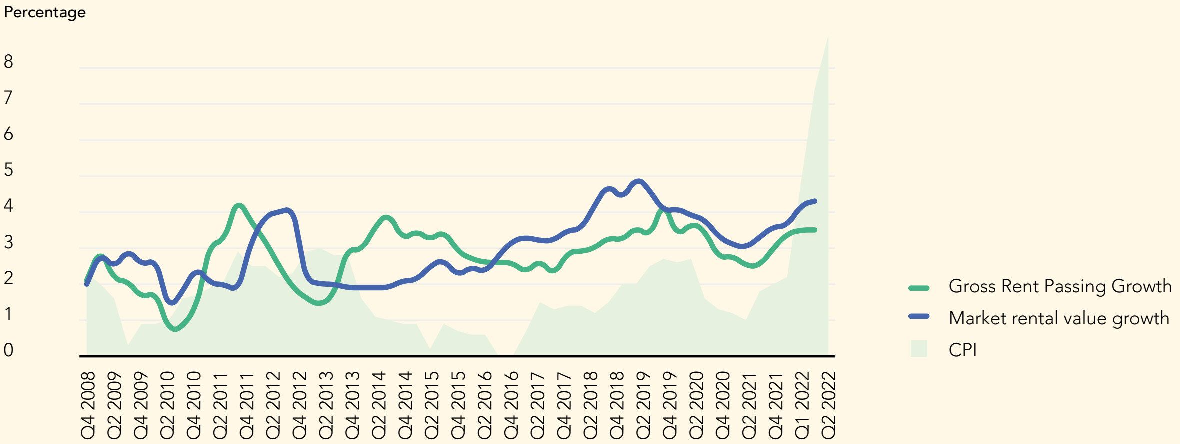
That said, the prospective regulation of the rental sector, especially the extension of the housing valuation system (WWS) to include mid-priced rental housing, will have a significant impact on market rents and hence on valuations. The details of the implementation have yet to be determined, however.

Figure 4 Developments in house prices and number of transactions in existing owner-occupied homes



Source: Statistics Netherlands, MSCI, 2022

Figure 5 Rental growth and Dutch CPI (y-o-y % change)



Source: Statistics Netherlands, MSCI, 2022

Offices

The Dutch office sector seems to be on hold as a result of hybrid working and economic uncertainty. Changes in office preferences, economic climate and the focus on attaining sustainability ambitions reveals different opportunities within varying market subsegments.

Occupiers of the Dutch office market remain hesitant due to uncertainties. The first quarter of 2022 recorded the lowest take-up in a single quarter since 2012. At 134,300 sq.m., take-up was 9% lower than in Q1 2021. Approximately 81% of take-up in the Netherlands was in the G5, with Amsterdam representing a share of 33%. The share of G5 and Amsterdam were both higher than in the same quarter last year. In addition, both Rotterdam and Utrecht showed above-average take-up levels with 22% and 18% respectively.

G5 office markets outperforming the general office market. Compared to the previous quarter, the vacancy rate decreased slightly by 73 bps to 11.0%, and the overall office stock continued to decline to just below 47 million sq.m. Many companies are continuing to reconsider their housing strategy in the wake of increased hybrid working, but have not yet taken action. This could potentially increase the availability of office space in the mid to long term.

Polarization continues between the best and the rest of the office market. Similar to the previous quarter, the average vacancy rate of offices near city centre locations in the G5 stood at around 5.4%. G5 city centre train stations remained below the natural vacancy rate of a well-functioning office market. This indicates that office space near transport hubs in the larger cities is still highly sought-after.

Average office rents in the G5 cities largely outperformed the Dutch average of € 140 per sq.m. The only exception is The Hague, where rents hover around the average. Amsterdam showed the highest outperformance, with an average rent of € 265 per sq.m. and a prime rent of € 475 per sq.m. in the Zuidas district.

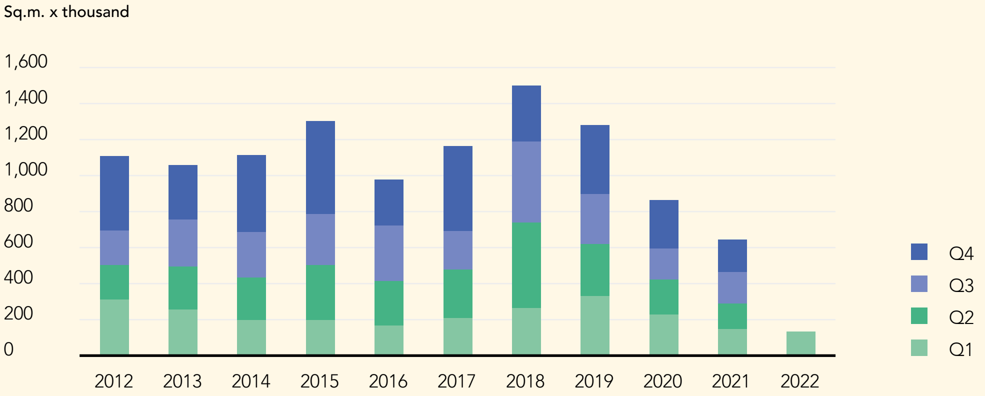
Investor appetite seems to be settling around the best office locations. Prime yields in the top central business districts (i.e. Amsterdam), the secondary CBDs in the G5 (i.e. Rotterdam) and major provincial cities remained fairly stable at 3.00%, 3.95% and 5.00% (-10 bps) respectively. At present, climate change, a push towards energy efficiency and potential green premiums are driving investor interest towards sustainable and modern offices, which are often located in the major cities. This shift is likely to manifest itself in the rest of the year, favouring prime yields in the top segment.

Table 1 Market indicators

Market indicator	Q1 2022	q-o-q growth	1-year growth	3-year growth
Average rent / sq.m.	€ 140	0.0%	0.0%	12.0%
Prime rent / sq.m.	€ 475	0.0%	4.4%	10.5%
Stock NL sq.m.	46,900,000	(0.4%)	(0.6%)	(2.6%)
Take-up NL sq.m.	134.3	(24.3%)	(8.8%)	(59.5%)
Vacancy NL sq.m.	5,168,380	(6.6%)	(7.0%)	(12.6%)
Vacancy rate NL	11.0%	(0.7%)	(0.8%)	(1.3%)
Vacancy rate G5 Intercity	5.4%	(0.1%)	0.5%)	0.6%
Prime yield – Prime CBD (Zuidas)	3.0%	0.0%	0.0%	(0.3%)
Prime yield – Secondary CBD G4	4.0%	0.0%	(0.2%)	(0.7%)
Prime yield – Major provincial cities	5.0%	(0.1%)	(0.4%)	(0.4%)

Source: CBRE, 2022

Figure 6 Take-up of Dutch office space



Source: CBRE, 2022

Outlook

Hybrid working will likely become the norm; corporate real estate strategies in focus. Going forward, office occupiers will likely focus more on the appeal and positive aspects of the work environment and an attractive office might well be an advantage in the war for talent.

The Dutch government's sustainability ambitions for offices include them obtaining energy label C as a minimum before 2023. The DGBC claims that 54% of the office stock does not yet meet this criterion. Due to potential mismatches, part of the obsolete office stock, which is advanced in age and poorly accessible, will likely be transformed in the future while some stranded assets will be structurally vacant.

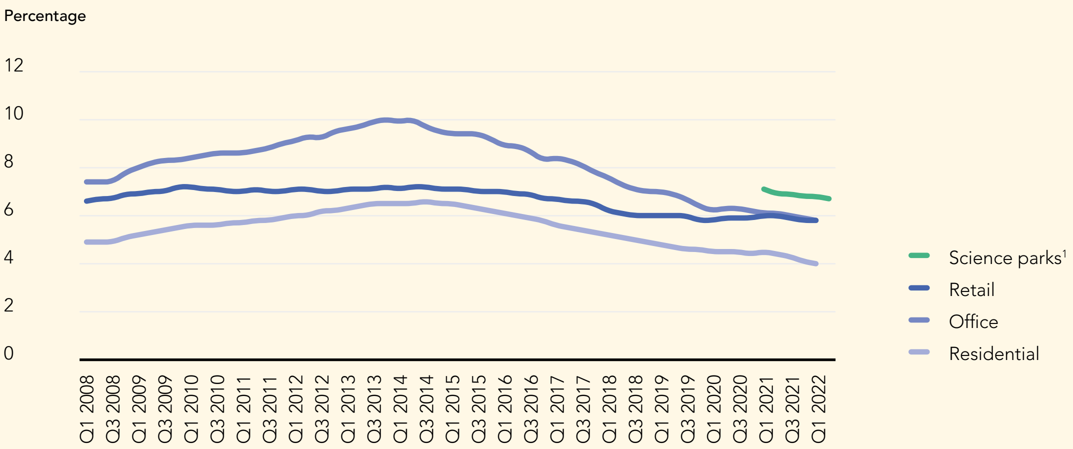
The current uncertainty surrounding hybrid working and the return to the office seems to more heavily affect offices in the Randstad conurbation, as the majority of employers requiring office space are located in that region. In addition, inflation pressure could cause businesses to critically assess their real estate footprint and consider ways to increase their sustainability standards.

Science parks

The long-term potential of the fundamentals of the knowledge-based economy, and spotlight on life sciences as a result of COVID-19 and an aging population, has led to increased investment interest in real estate on Dutch science parks.

Science park yields continue to show a premium. Yields of a bespoke science park benchmark as defined by a.s.r. real estate continue to be at a premium compared to traditional asset classes of the MSCI Quarterly Benchmark, as shown in figure 7. Reversionary yields of commercial real estate on science parks for the second quarter are between 9.8% and 4.1%, with an average of 6.7%. This represents a decrease of 15 bps compared to the first quarter of 2022. Yields in the traditional asset classes of the MSCI Netherlands benchmark also sharpened in the first quarter. As a result, the spread with science parks remained virtually the same for all asset classes: 270 bps for residential and 90 bps for offices and retail.

Figure 7 Gross reversionary yields



Source: MSCI, a.s.r. real estate, 2022

Market developments

Public-private partnerships are expanding. The VU Amsterdam joined the Amsterdam Science Park consortium, whose members are the City of Amsterdam, the University of Amsterdam and Rabobank, to further expand the number of Matrix Innovation Centers in the capital city. A seventh iteration of the Matrix Innovation Center is to be built at Amsterdam Science Park and the eighth building will be constructed at the VU Campus. All parties have agreed to invest up to € 400 million; by 2032, the consortium aims to complete and operate 12 matrix buildings at the four science parks in Amsterdam. In addition, Kennispark Twente in Enschede will undergo a major redevelopment of approximately € 100 million. This will be funded by public and private investments. In the coming years, the urban environment will be improved and various research centres and single and multi-tenant buildings will be constructed. Collaborative commercial real estate development is one way to accelerate innovation.

According to the Global Startup Ecosystem Report by Startup Genome, Amsterdam ranks 14th globally and second in Europe, after London, as a startup ecosystem.

1 Commercial real estate benchmark on science parks as defined by a.s.r. real estate

Amsterdam excels as one of the fastest-growing ecosystems in Europe. Besides having a strong cleantech startup scene, the Amsterdam region stands out for its Agritech & New Food and Life Sciences sub-sectors thanks to a range of international offices and the presence of university medical centres. The main pull factors for businesses towards the Netherlands are international-minded human talent, a competitive economic climate and established startup hubs.

Outlook

Hybrid working trend has a limited impact on science park real estate. R&D facilities often require an on-site presence and the jobs they offer are of a specific nature that is difficult to replicate. Therefore, it is likely that science park real estate will only suffer from the working-from-home trend that gained traction during the pandemic to a highly limited extent. Looking ahead, science parks are expected to continue attracting businesses, which means that the stable and low vacancy rate will stay at the current levels. The long-term potential of the fundamentals of the knowledge-based economy, and the spotlight on life sciences in particular, would indicate that science parks are expected to remain attractive investment opportunities.

Entrepreneurial activity in times of crisis. Post-pandemic and geopolitical tensions can lead to uncertain economic times. Generally, times of crisis tend to encourage economic activity and lead to an increase in business development, which is shown in the ever-growing venture capital that is being invested in high-performing Dutch startups. That said, the current increase in interest rates is likely to narrow company investments, most notably in innovation. Additionally, rising interest rates will impact the financing scope of venture capitalists. For science parks, fewer company investments might lead to the potential failure of startups, which will result in job losses, will limit spatial demand at science parks and will increase vacancy levels. However, in relative terms, large corporates still support the majority of jobs at science parks.

The ability to retain companies, in all commercial phases, is vital for the success of science parks and the ecosystem as a whole. In this article we focus on the stickiness of companies (their tendency to stay, or leave) on Dutch science parks, factors which influence this behaviour and possible solutions aimed at increasing the duration of stay of tenants.

Farmland

The agriculture sector is transitioning to a sustainable sector, but far reaching government measures are currently causing a restraint on the farmland market. Despite the challenges, prices of farmland are still going strong and the strong demand for commodities results in better farmland prices.

The trade in agricultural goods is still going strong, but scarcity and prices are increasing. However, the impact varies greatly between agricultural commodities and several sectors have been affected by the disrupted international food markets, especially those selling large volumes to the hospitality industry. The conflict in Ukraine is still disrupting the global market for (organic) maize, wheat, sunflower seeds and rapeseed. Shortages in livestock feed in particular and the price of fertilizer have also risen sharply.

The average income of Dutch agricultural firms increased sharply in 2021 to an estimated € 67,000. This is € 17,000 higher than the average for 2020, the year in which income fell sharply, partly due to the pandemic-related measures. The income for 2021 was also € 7,000 higher than the average for 2016-2020. Average turnover per agricultural and horticultural firm rose by 13% in 2021, mainly due to higher selling prices for products and pandemic-related support measures. This increase was higher than the increase in the average costs (+10%) of energy, feed and fertilizer in particular in 2021.

Prices of farmland are still going strong, traded farmland is declining. The average price of farmland (12-month average) is currently approximately € 70,500 per hectare, with prices for arable farmland at € 80,700 per hectare and grassland at € 64,700 per hectare. Due to a new calculation method of Kadaster/WER, the average price for arable land in particular has risen sharply. Compared to the average price of farmland in the same period a year ago, farmland prices have increased by 9%. As prices rose, the number of transactions declined by 12% to approximately 32,500 traded hectares on an annual basis. The uncertainty about agricultural policy and the economy is causing a reluctance on the farmland market.

Far-reaching measures in National Program for Rural Areas causes a stir. On 10 June, Minister van der Wal presented her Initial Memorandum on a National Program for Rural Areas' to the Dutch House of Representatives. The National Program for Rural Areas (Dutch acronym: NPLG) is meant to support the integrated area-oriented approach to improve the quality of nature, soil, water and the climate. With this program, the central government aims to make guiding choices and define regional targets to ensure that the national targets for reducing emissions are met. The program contains a map of the Netherlands with the required reduction of NH_3 (nitrogen) emissions for each sub-area. There are major differences by region: in parts, the target is a 12% reduction, but near 131 Natura 2000 areas, emissions must be reduced by between 70% and 95%. This means that, by 2030, 74% of the areas near nitrogen-sensitive nature will fall below the so-called critical deposition value. This program has sparked a lot of discussion and discontent among farmers and resulted in protests by farmers, who blocked highways and access roads to and from supermarket distribution centres.

It is unclear at this point how exactly this reduction target will be implemented by the provinces. The intended reduction can be achieved through technological innovations and changes in business operations (such as reducing the number of livestock).

Outlook

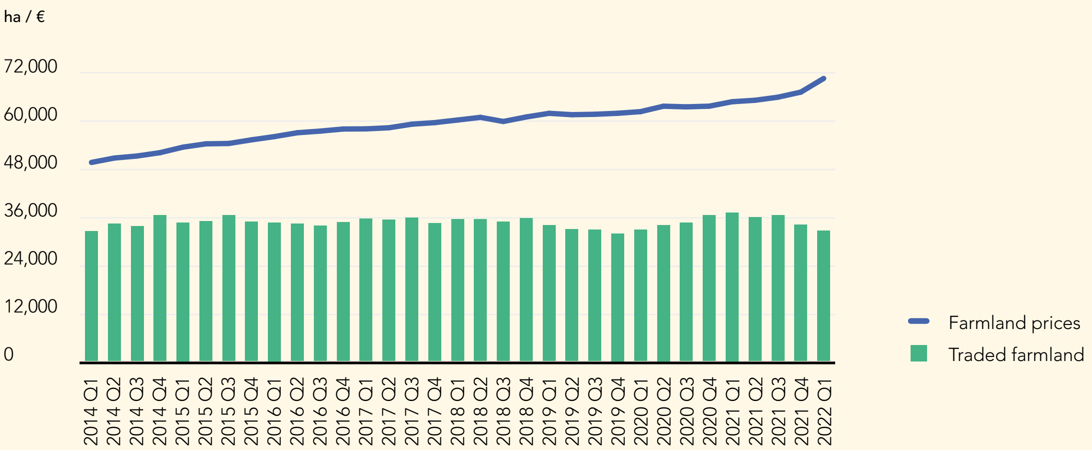
For the coming quarters, the outlook for the agriculture sector remains positive, but there are a number of challenges. More will become clear about the implementation of the NPLG and its impact on the sector (especially on livestock farms). In addition, the economic outlook still shows pressure on commodities around the world; higher prices for products are expected, while shortages of animal feed and fertilizer are adding an entirely new dimension. There is still considerable uncertainty about how the pandemic, the situation in Ukraine and the economic situation will develop during 2022 and beyond. Extension of derogation for the Netherlands is expected to change significantly. The European Commission is expected to provide clarity in September. Meanwhile, the transition of the agriculture sector will continue, and it is clear that increased dynamics will emerge in the farmland market as well as in the business development of agriculture firms and the demand and need for financing.

Table 2 Farmland market indicators

Market indicator	Q1 2022	q-o-q growth	1-year growth	3-year growth
Export of agriculture goods (in millions)	€ 26,952	4.0%	11.4%	20.2%
Farmland (12-month average)	€ 70,469	5.1%	9.0%	14.1%
Traded hectares (12 month)	32,490	(4.3%)	(12.3%)	(4.1%)
Available farmland (in ha)	1,811,910		0.0%	(0.2%)
Number of agricultural farms	52,110		(1.1%)	(3.3%)

Source: Kadaster, Wageningen Economic Research (WER), 2022

Figure 8 Farmland prices & traded farmland



Source: Kadaster, Wageningen Economic Research (WER), 2022

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